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## Securitisation in Croatia and Serbia: current status and outlook

### **Arijana Petres**

Petres & Cvirn Law Firm

### **Matija Vojnović**

Moravčević Vojnović Zdravković OAD in cooperation with Schönherr

### **Martin Ebner**

Schönherr Rechtsanwälte GmbH

With turmoil in the structured finance markets in the United States, the United Kingdom and many Western European countries, it is difficult to predict whether 2008 will see many structured finance/securitisation transactions originating in Central and Eastern Europe (CEE). So far, local financial markets have been relatively immune to the lack of liquidity that has affected other markets. Similarly, the relevant investor base appears to have a continuing appetite for local assets.

In view of this and driven by an increasing demand for consumer and mortgage finance, several CEE jurisdictions are attempting to establish legal frameworks for securitisation. Such specialist securitisation laws should help to develop the national securitisation markets.

The countries in which legislative initiatives are underway (some countries, such as Romania, have already enacted special securitisation legislation) include Croatia and Serbia. Although they stem from a uniform legal background, the Croatian and Serbian legal initiatives show remarkable differences.

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## Croatia

### Status quo

#### *True sale*

Croatia does not yet have a special securitisation law in place and no special securitisation provisions are contained in other laws. Accordingly, true sale securitisation must be implemented on the basis of general civil law principles concerning the transferability of receivables as set forth in the Law on Obligations. Subject to certain exemptions (eg, concerning receivables of a strictly personal nature and receivables where the underlying contract contains a non-assignment clause), Croatian law recognises the concept of the assignment of receivables, which in principle is valid regardless of the debtor consenting to the assignment or being notified thereof.

Although under the Law on Obligations ancillary rights (eg, mortgages, pledges, interest, contractual penalties) automatically transfer from the originator to the purchaser along with the underlying receivables, certain ancillary rights require a special mode of transfer in order to be attributable to the purchaser. Such special mode of transfer is required for ancillary rights that are acquired by means of entry in a relevant public registry (eg, mortgages, pledges over immaterialised securities, registered pledges over movables and rights).

#### *Bankruptcy claw-back*

Pursuant to the Bankruptcy Act, a receivables purchase at an undervalue will be exposed to the same risk of challenge by the bankruptcy trustee and/or bankruptcy creditors as any other transaction entered into by the originator at an undervalue. In the case of fraudulent transactions, the challenge period runs for 10 years.

#### *Regulatory*

Under current Croatian law, the purchase and servicing of receivables is a business activity free of licensing requirements (as long as it is carried out by entities other than banks). However, securitisation transactions among residents and non-residents shall be reported to the Croatian National Bank for statistical reasons.

### Draft Securitisation Law

The Ministry of Finance first put the drafting of a securitisation law on its agenda in 2006. Accordingly, it employed a legal drafting team comprising representatives of the Ministry of Finance, the Croatian National Bank, the Croatian Financial Services Supervisory Agency, the Croatian Banking Association and other experts, with the goal of examining potential regulatory barriers for securitisation transactions in Croatia. The working process has been monitored and supervised by European Bank for Reconstruction and Development and World Bank Convergence Programme representatives, with the aim of ensuring a high level of expert knowledge and protecting the public interest. The drafting process lasted more than one year and resulted in the draft Securitisation Law, which is expected to enter into force in 2008.

#### *Types of transaction and regulation*

The draft law applies to true sale and synthetic securitisation transactions performed by local entities, as well as to foreign securitisation entities with respect to securitisation business performed in Croatia. Implementation of the draft law shall be supervised by the Financial Services Supervisory Agency, the regulator.

#### *Participants*

The draft law covers securitisation funds as well as corporate securitisation special purpose vehicles. While the draft law contains definitions of the usual participants to such transactions (notably including provisions concerning a note holder trustee), it is relatively liberal in terms of the regulation of transaction participants (although these must be registered with the regulator). However, unless servicing is conducted by the originator or a bank, the servicer of the receivables must meet certain criteria (in terms of minimum capital and suitability) in order to be permitted to service the receivables. In addition to certain provisions dealing with the regulatory status of the servicer, the draft law contains provisions as to the segregation of assets and provides that serviced

receivables, as well as the proceeds thereof, are not part of the servicer's estate and are exempt from attachment by the servicer's creditors.

#### ***Securitized assets, transfer and related provisions***

The draft law does not limit the receivables to which it applies. Any type of receivable (including future receivables), as well as groups of similar receivables classified by type, source, time of creation and/or other common characteristics, may be securitised, provided that the value of the securitised assets is determined by an independent auditor. The draft law also provides that all ancillary rights (including those that would otherwise have to be re-registered) will transfer automatically upon the assignment of the underlying or secured receivable.

Note holders and certain transaction creditors benefit from a preferential right to and statutory pledge over the securitised assets.

If the originator continues to collect the transferred receivables for the purchaser, debtor notice can be effected by publication in the *Official Gazette* and one daily Croatian newspaper.

While the draft law contains strict confidentiality obligations, it provides that confidential information can be freely transferred among the transaction parties (eg, from originator to purchaser).

#### ***Bankruptcy claw-back limitations***

The draft law contains special provisions limiting the bankruptcy trustee's possibilities to avoid true sale transactions. Moreover, in connection with securitisation transactions, the bankruptcy trustee's cherry-picking and termination rights are limited.

### **Serbia**

#### **Status quo**

##### ***Feasibility of securitisation***

At present, securitisation is not regulated in Serbia. Due to the lack of special provisions dealing with this type of transaction, a true sale securitisation concerning Serbian assets must be structured under general civil

law principles on transferability of receivables as set out in the Law on Obligations. Moreover, for receivables deriving from foreign trade or foreign credit transactions, certain special provisions of the Foreign Exchange Law apply. While an assignment in principle (subject to customary limitations concerning personal receivables and non-assignment clauses) is possible, a cross-border true sale of domestically originating receivables may be difficult under the existing legal framework, particularly given the restrictive interpretation of the Foreign Exchange Law by the Serbian authorities.

In general, accessory rights such as related security attached to a receivable transfer automatically with the receivable. However, for secured receivables additional perfection steps may have to be taken (depending on the type of collateral and where it has been registered – for example in the Pledge Register, the Central Securities Register or land books).

#### ***Regulation***

At present, the sale, purchase or collection of receivables is not subject to any direct licensing requirements. However, coordination with competent authorities, such as the National Bank of Serbia and the Foreign Exchange Inspectorate, is recommended. Special provisions apply for receivables deriving from foreign trade or foreign credit transactions.

#### ***Bankruptcy claw-back***

The Law on Bankruptcy Proceedings, which sets out the general legal framework concerning the avoidance of contracts that were entered into prior to the commencement of bankruptcy proceedings, also applies to a receivables sale by a Serbian originator.

#### **Draft Securitisation Law**

On various occasions the National Bank of Serbia has informally expressed the view that under the current legal framework, smooth and efficient securitisation cannot be achieved; nor would it be possible to achieve the economic objectives of securitisation. While this

opinion is debatable, the National Bank of Serbia nonetheless formed a working group to prepare a law on securitisation. The draft Law on Securitisation was published on January 17 2008. Some of the most important aspects of the draft law are outlined below.

#### ***Types of transaction***

The draft law applies to true sale and synthetic securitisation transactions.

#### ***Participants***

Under the draft law, the purchaser should be established in the form of a management company which would manage securitisation funds, rather than in the form of an orphan securitisation special purpose vehicle. According to the draft law, the management company must be a limited liability company headquartered in Serbia and the draft law applies only to domestic Serbian transactions. The National Bank of Serbia has taken the approach that allowing cross-border securitisation by introducing a foreign-based special purpose vehicle into the securitisation structure could reduce investment opportunities for domestic investment and pension funds due to the participation of more competitive foreign investors; thus, this provision attempts to protect local investors.

#### ***Transfer of securitised assets and related provisions***

The draft law further stipulates that only banks and leasing and insurance companies, whether based in Serbia or abroad, may act as originators, thus excluding corporate originators and their assets. The main reason for cutting off access to international capital markets for many potential originators is because the National Bank of Serbia believes that the Serbian capital market is still too unstable for participants that are not under National Bank supervision to securitise their receivables, which could create macroeconomic instability and inflation pressures. This is also the reason for limiting the receivables which can be securitised under the draft law to, for example, mortgage-backed assets, securities and leasing generated receivables.

While the draft law provides that, alongside the receivables purchase, mortgages, pledges, interests and guarantees are transferred to the management company, the Law on Mortgages still provides that an assignment of mortgage-backed receivables shall be effective only as of the moment of re-registration in the relevant land registers (which is a time-consuming and costly process).

The draft law introduces a statutory pledge on the securitisation fund's assets as security for the note holders' claims and also recognises the concept of tranching or a cash waterfall.

#### ***Regulation***

Pursuant to the draft law, only entities active in the same industry as the originator may act as (substitute) servicers. Moreover, the servicer must be Serbian if a certain amount of the securitised receivables is owed by Serbian debtors. This may create practical problems of appointing a back-up servicer that has the (technical) capability of servicing, for example, a large pool of bank receivables.

Overall, the supervisory model proposed under the draft law is very similar to patterns used in regulated finance industries (eg, banking, insurance, investment funds, pension funds, financial leasing) and conflicts with cost-driven securitisation structures. The main supervisory authority is due to be the Serbian Securities Commission, which has the power to grant licences to management companies and to clear mergers and acquisitions.

#### ***Comment***

Although both the Croatian and Serbian authorities recognise the importance of securitisation as a refinancing and balance-sheet management tool for local originators, Croatian efforts in this respect appear to be further advanced. It remains to be seen whether lobbying by local banks and other market participants will prompt the Serbian National Bank to rethink its approach to regulating an industry that is still in its infancy. Unfortunately, recent developments in mature securitisation markets worldwide may work against such lobbying efforts.